

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN AUDIT OF UNIVERSAL LOCAL ACCESS )	ADMINISTRATIVE
SERVICE CHANNEL REPORTS )	CASE NO. 316

O R D E R

On April 30, 1987, the Commission issued an Order in Case No. 8838<sup>1</sup> that authorized a ULAS<sup>2</sup> audit and the creation of a task force to supervise the audit. In addition, the task force was directed to consider and make recommendations to the Commission concerning the scope of the audit, audit criteria, refunds and credits based on audit results, audit funding, an audit agent, and other matters that may arise.<sup>3</sup>

On October 30, 1987, the Commission issued its Order in Administrative Case No. 316 establishing a procedure whereby Commission Staff would act as a team to attempt to achieve a consensus among the parties on issues that must be resolved before an audit is initiated. Staff was charged with the responsibility of submitting a written report and recommendations to the

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<sup>1</sup> An Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements for Telephone Utilities Pursuant to Changes to be Effective January 1, 1984. Phase II.

<sup>2</sup> Universal Local Access Service.

<sup>3</sup> Order in Phase II of Case No. 8838, dated April 30, 1987, page 23.

Commission with any dissenting opinions of the parties attached thereto.

The Commission has reviewed the "Report to the Commission," attached as Appendix A to this Order, and the dissenting opinions of AT&T Communications of the South Central States, Inc. ("AT&T"), filed April 19, 1988, and of MCI Telecommunications Corporation ("MCI"), filed April 20, 1988, and other matters of record regarding the ULAS audit. The responses to the parties' dissents are individually addressed as follows.

AT&T's response objects to the recommendation of the Commission Staff that the audit should be paid on an as-completed basis using the allocator in effect during the audit process. AT&T proposes that the cost of the audit should be paid by the party requesting the audit unless another party is found to be in non-compliance, in which case that carrier should be liable for the cost of the audit.

In the opinion of the Commission, allocating the cost of the audit based on the allocator in effect during the audit is the most reasonable, the most equitable, and the least complex method available. In support of its position, the Commission points out that, in accordance with the ULAS tariff, other administrative costs are included in the ULAS revenue requirement.

If, as AT&T proposes, the cost of the audit is borne by the party requesting the audit, the cost will be inordinately burdensome on the smaller carriers seeking relief. Further, as AT&T proposes the cost of the audit is borne by the carrier found

to be in non-compliance with the tariff provisions, if audit results determine that all carriers are to some extent in non-compliance, then some allocation method would still have to be selected. Thus, the Commission is of the opinion that the audit cost should be allocated on an as-completed basis based on the allocator in effect during the audit.

In its filed comments in response to the "Report of the Commission," MCI states that it believes that the ULAS audit adjustments should be implemented as soon as the audit of any carrier has been completed because true-ups implemented after all carriers are audited favor AT&T and disadvantage the non-dominant carriers.

In the opinion of the Commission, audit adjustments should be implemented only after all carriers are audited. This method is administratively simplest due to the joint nature of the tariff. Further, as regarding other Commission-sanctioned audits, no action is taken on preliminary findings, but only after the final audit report is presented are any findings implemented.

MCI also proposes in its filed comments that producing further documentation on interexchange carrier networks and deposing appropriate knowledgeable persons on interexchange carrier networks may be beneficial to narrowing issues and expediting the audit.

In the opinion of the Commission, adequate attention was given to a phase of discovery during the informal conferences and cooperation between the two major carriers is doubtful. The Commission concludes that the ULAS audit which it authorized

should proceed so that an independent firm will collect and evaluate the information necessary to resolve the issues.

As a result of its review, the Commission is of the opinion and finds that the task force recommendations as stated in the "Report to the Commission" should be accepted. The Commission will entertain petitions for hearing on issues that the parties may wish to argue.

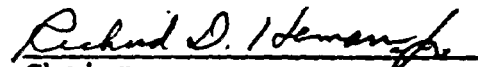
IT IS THEREFORE ORDERED that:


(1) The ULAS audit task force recommendations as set out in Appendix A be and hereby are approved.

(2) The parties retain the documents relevant to this audit until the investigation is concluded.

Done at Frankfort, Kentucky, this 3rd day of June, 1988.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Executive Director

## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN ADMINISTRATIVE CASE NO. 316 DATED 6/3/88

#### REPORT TO THE COMMISSION

#### AN AUDIT OF UNIVERSAL LOCAL ACCESS SERVICE CHANNEL REPORTS

ADMINISTRATIVE CASE NO. 316

#### INTRODUCTION

On April 30, 1987, the Commission released an Order in Case No. 8838<sup>1</sup> that authorized a ULAS<sup>2</sup> audit pursuant to tariff<sup>3</sup> and created a task force to supervise the audit. The task force was directed to consider and make recommendations to the Commission concerning the scope of the audit, audit criteria, refunds and credits based on audit results, audit funding, an audit agent, and other matters that may arise.<sup>4</sup>

The initial Order in Administrative Case No. 316 provides that the Commission Staff ("Staff") assigned to this investigation will act as a team and attempt to achieve a consensus among the parties on issues that must be resolved before an audit can be initiated. The Order further provides that in areas where a

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<sup>1</sup> An Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements for Telephone Utilities Pursuant to Changes to be Effective January 1, 1984. Phase II.

<sup>2</sup> Universal Local Access Service.

<sup>3</sup> South Central Bell Telephone Company, Tariff 2J, Universal Local Access Tariff, Section J3. Rate Regulation, Page No. 2.

<sup>4</sup> Order in Phase II of Case No. 8838, dated April 30, 1987, page 23.

consensus can be achieved, that recommendation should be made to the Commission, and in areas where a consensus cannot be achieved, the Staff should make a recommendation. In either case, the parties will be allowed to state any dissenting opinions.<sup>5</sup> The purpose of this report is to make those recommendations and to present to the Commission any dissenting opinions of the parties.

Upon submission of this report and any dissenting opinions to the Commission, the Commission will enter its decision concerning task force recommendations and entertain petitions for hearing on issues that the parties may wish to argue. Absent any petitions for hearing, or subsequent to hearing should such petitions be filed and granted, the Commission will authorize Staff to prepare a request for audit proposals ("RFP"). The parties will be permitted to review the request for audit proposals and recommend changes prior to its release to bidders. Finally, the Commission will select an auditor from the bids it receives.

#### DISCUSSION

In order to begin this investigation, informal conferences were held on January 5 and 6, 1988, and on February 17, 1988. A list of those who attended the conferences is appended. In the order in which they appear in the initial procedural Order in Case No. 316, the issues are discussed, the positions of the parties are stated, and Staff's recommendations are presented.

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<sup>5</sup> An Audit of Universal Local Access Service Channel Reports, dated October 30, 1987, page 2.

### Scope of the Investigation

1. Should the ULAS audit be structured to include all or some interLATA carriers.

A consensus among the parties was reached that all carriers subject to the ULAS tariff should be audited.

Staff, therefore, recommends that all carriers subject to the ULAS tariff should be audited.

2. Should the ULAS audit proceed in stages beginning with AT&T and move to MCI, US Sprint and Allnet as necessary.

In its Order in Case No. 316, dated October 30, 1987, the Commission tentatively concluded that the ULAS audit should proceed in stages, beginning with AT&T and moving to MCI, US Sprint and Allnet, as necessary. Such an order of audit recognizes the relative size of these carriers and the consequent impact of any misreporting on ULAS allocations. Also, the Order contemplates it should allow a smooth audit process and may reduce audit costs.

A consensus among the parties was reached that, to the extent possible, the audit process should start with AT&T because it is the largest carrier.

Staff concurs with the Commission's tentative conclusion that the audit should proceed in stages, should begin with an audit of AT&T, and should include all carriers subject to the ULAS tariff.

3. Should a simultaneous audit be performed on all interLATA carriers.

Staff discussed its position regarding a simultaneous audit of all carriers in the context that it is dependent upon an auditor's work plan as to how an auditor's resources are assigned to the various carriers during the audit process. No party objected to Staff's position. Therefore, Staff recommends that the audit should begin with AT&T and include all other carriers subject to the ULAS tariff.

4. Should South Central Bell's actions as pool administrator be investigated.

Consensus among the parties was reached regarding the role of South Central Bell as pool administrator. It is agreed by all that South Central Bell possesses certain information and knowledge that an auditor will need to access. The extent to which South Central Bell's actions as pool administrator are investigated may involve a check on the clerical accuracy of South Central Bell's calculations in rendering the ULAS bills.

In its Order in Case No. 316, the Commission stated:

At this point, it is not contemplated that the audit will include an investigation of South Central Bell's actions as pool administrator.<sup>6</sup>

Staff recommends that a check on the clerical accuracy of South Central Bell's calculations in rendering the ULAS bills should be performed by the auditor.

#### Audit Criteria

5. Discussion of the development of technical definitions and other guidelines as necessary to conduct the audit.

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<sup>6</sup> Ibid., page 4.



The Commission, by Order<sup>7</sup>, provided that it would not offer guidance in this area beyond the terms and definitions contained in the ULAS tariff and associated implementation procedures issued by the pool administrator, and contemplated that the parties will develop a set of definitions and other guidelines as necessary to conduct the ULAS audit.

MCI's position is that this is the first time the tariff definitions have been tested, other than by a single party applying the definitions, and that there may be interpretations or questions on what a definition means. Further, MCI is in the process of considering and evaluating various tariff issues and may, at some point, ask for a formal interpretation.

AT&T's position is that care should be exercised to interpret the tariff only and not rewrite the tariff.

Staff recommends that the audit focus on those definitions which are provided by the ULAS tariff and implementation guidelines. Furthermore, in instances where the auditor requires clarification, such clarification should be requested from the Commission.

#### Refunds and Credits

6. Should true-ups be implemented immediately after the audit of a particular carrier is completed or only after all carriers are audited.

The Order of April 30, 1987, in Case No. 8838, conditioned any true-up "on the showing of ULAS channel count

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<sup>7</sup> Ibid.

misreporting."<sup>8</sup> The Order of October 30, 1987, in Case No. 316, stated "[t]he Commission will maintain this standard."<sup>9</sup>

AT&T's position is that true-ups would be implemented only after all carriers are audited and MCI's position is that adjustments should be made as the audit of each carrier is completed.

Staff recommends that true-ups should be implemented only after all carriers are audited.

7. Should some standard of materiality be established.

Staff's recommendation is, with regard to the materiality of final audit results, that a true-up should be made based on actual results. With regard to materiality as it relates to statistical sampling of channel count reports, Staff's recommendation is to defer the issue until the RFP is developed. MCI reserved comment on the issue of materiality until the appropriate time. AT&T also deferred a position on this issue.

Audit Funding

8. Discussion of the timing and method of cost recovery.

South Central Bell requested that the ULAS audit bills be paid directly by the carriers and that South Central Bell not be the conduit for payment.

Staff's position is that the discussion of the method of payment may be premature and dependent upon the terms of a

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<sup>8</sup> Order in Phase II of Case No. 8838, dated April 30, 1987, page 26.

<sup>9</sup> An Audit of Universal Local Access Service Channel Reports, dated October 30, 1987, page 5.

contract with an auditor. Staff recommends that the issue of timing and method of cost recovery be deferred until such time as a contract with an auditor is negotiated.

9. How should the cost of the audit be allocated among the parties.

The Order in Case No. 316, stated:

"It is the Commission's tentative conclusion that the cost of the audit should be recovered from interLATA carriers through ULAS charges. However, the Commission will entertain other recommendations such as that each carrier finance the cost of its audit or that any carrier(s) seeking an audit of another carrier finance the cost of the audit."<sup>10</sup>

MCI's position regarding the allocation of the cost of the audit is that the current channel count allocator is not a fair and accurate measurement of usage and that the carriers should pay the total cost of the audit based on the allocator adopted in Administrative Case No. 311.<sup>11</sup> AT&T's position regarding the allocation of the cost of the audit is bifurcated. On one hand, AT&T believes the "cost causer" should pay the entire cost of the audit, but on the other hand AT&T stated that if AT&T is found in substantial noncompliance, AT&T will pay the entire cost of the audit, provided that MCI assumes a similar risk.

Staff recommends that the audit should be paid on an as-completed basis using the allocator in effect during the audit process.

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<sup>10</sup> Ibid.

<sup>11</sup> Investigation of InterLATA Carrier Billed Minutes of Use as a ULAS Allocator.

10. If the audit results demonstrate that a carrier underreported its channel count causing other carriers to pay more than its properly allocated share, should the carrier that underreported be required to pay interest to the other carriers that have been affected.

Staff's position is, in considering the time value of money, there should be some market rate of interest applied. MCI's position is the interest rate to be charged should be the market value of money and AT&T's position is that both the legal issue as to whether or not interest applies in this situation, and Commission precedence are considerations to be addressed before either the market rate or statutory rate is applied. South Central Bell raised the issue that a late payment/penalty rate is provided in the tariff. Staff and all parties agreed that there is a time value of money and expressed concern over how it can be applied in this situation.

Staff recommends that this issue be addressed at a later date by the auditor.

Audit Agent

11. Should a consultant be retained to conduct the ULAS audit.

In the Order in Administrative Case No. 316, "[t]he Commission concludes that it should contract with a consultant to conduct the ULAS audit."<sup>12</sup>

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<sup>12</sup> An Audit of Universal Local Access Service Channel Reports, dated October 30, 1987, page 6.

Therefore, Staff recommends that an independent auditor should be retained to conduct the audit.

12. What process should be used to select a consultant.

Staff recommends that the selection of the auditor should mirror the current auditor selection process as it relates to management audits. Staff recommends using the management audit bidders list, supplemented by firms suggested by the parties, for the group of firms to receive the RFP.

From the firms that submit a bid proposal, various criteria will be used to evaluate the best proposals. The bid proposals will then be narrowed to four firms who will be asked to make oral presentations to the Commission and Staff, and then the final selection will be made.

The bid proposals will also be provided to the carriers and the carriers will be invited to make comments on and recommendations regarding the proposals. If the parties can agree on an audit firm, Staff will recommend to the Commission that that firm be retained to conduct the audit.

No party objected to this selection process.

13. Discussion of criteria that should be used to select a consultant.

Staff recommends using criteria similar to those used in selecting a management audit firm such as, for example, how the firm intends to address the scope, the comprehensiveness of the work plan, the qualifications and background of the firm, the cost of the audit and any conflict of interest concerns. No party objected to these criteria.

14. How should the consultant coordinate activities with the audit task force, and what role should the participants have in the audit.

Staff recommends that it coordinate the audit and be the sole point of contact for the audit firm.

The role of the participants in the audit should be similar to that of the audited firm in the management audit context. The participation of South Central Bell will be limited to answering questions, providing information about the tariff and the implementation guidelines, and producing documents and supporting calculations. The role of the carriers as participants in the audit will be to answer data requests, to have relevant company personnel available for interviews and to produce documents.

Staff further recommends that the participants be invited to file comments on both interim and final reports and be able to cross-examine the auditor at any hearing that may occur.

No party objected to this process.

#### Other Matters

15. Should a phase of discovery be allowed as a preliminary to the audit process.

During the first informal conference, the discussion among the parties regarding a phase of discovery which would precede a formal audit resulted in a meeting of technical representatives of the major parties to develop a data request to be simultaneously answered by AT&T and MCI. Confidentiality agreements were executed between AT&T and MCI, and January 25,

1988, was established as the latest date to answer the data request.

All parties were in agreement that a phase of discovery, and perhaps this data request in particular, could serve to create a more narrowed, focused, limited scope audit which would benefit all parties involved.

During the second informal conference, the assessment of the data request responses was discussed by the parties. MCI's assessment of AT&T's response to the data request was that the answers to the questions were helpful but had limited usefulness. MCI's position was, and AT&T concurred, there was nothing further to be gained through the discovery process.

Staff recommends that the audit proceed without any further consideration being given to a phase of discovery.

#### Procedural Issues

##### 16. Discussion of the development of a request for proposal.

During the first informal conference, Staff presented the process of developing a RFP in the management audit context. It will be Staff's responsibility to develop a draft RFP and furnish it to all carriers and other Task Force members. All parties will be provided an opportunity to comment on the RFP and to make recommendations concerning changes. Staff will review the proposed changes along with the Commission and then develop a final RFP. The Commission will issue the final RFP to the potential bidders.

Staff recommends the use of the same procedure for developing a RFP in the management audit context for the ULAS audit and no party objected.

17. What, if any, other matters should be discussed with regard to the procedural issues of the ULAS audit.

As a further procedural issue, Staff discussed during the first informal conference the retention of the documents maintained by the carriers and by South Central Bell which create an audit trail to support the channel reports. The tariff provides a retention period for the documentation and Staff stressed the importance of retaining the documentation beyond this retention period while this matter is being investigated. All parties conceded to the retention of the documentation during this investigation.

Staff recommends that the parties be ordered to retain the documents necessary to create an audit trail beyond the three year retention period and until such time as the investigation is concluded.



**ATTACHMENT**

**ATTENDANCE AT INFORMAL CONFERENCES ON AN AUDIT  
OF UNIVERSAL LOCAL ACCESS SERVICE CHANNEL REPORTS  
ADMINISTRATIVE CASE NO. 316**

January 5 and 6, 1988  
February 17, 1988

<b>NAME</b>	<b>ORGANIZATION</b>
Mary Anne Gill	Public Service Commission
Amy E. Dougherty	Public Service Commission
Martha M. Morton	Public Service Commission
* Doug Brent	Public Service Commission
Elie El-Rouaiheb	Public Service Commission
Bill Strack	Public Service Commission
Rose Marie Clements	Public Service Commission
Jim Sharpe	Public Service Commission
Bob Redmond	Public Service Commission
Robert McKee	AT&T
Charles Willis	AT&T
Ken Rejba	AT&T
Mike Hunter	AT&T
Eric Ison	AT&T
Trey Campbell	AT&T
John Brasell, Jr.	AT&T
Stephen Rausch	South Central Bell
Jim Tipton	South Central Bell
Fred Gerwing	South Central Bell
Creighton Mershon	South Central Bell
* Jim Harralson	South Central Bell
Kent Hatfield	MCI
Kenric E. Port	MCI
Don Evans	MCI
• Kendrick Riggs	MCI
Loren Burnett	MCI
• Tony Key	US Sprint
** Katie Yunker	US Sprint
Charles Wuest	Cincinnati Bell
Pamela Johnson	Attorney General
• Gail Leeco	Attorney General
** Bill Chambliss	Attorney General

- Attended January 5 and 6, 1988, only.  
\*\* Attended February 17, 1988, only.